THOMPSON
COE
Thompson, Coe, Cousins & Irons, L.L.P.
Attorneys and Counselors

Jay Thompson
Direct Dial: 512-703-5060
jthompson@thompsoncoe.com

Austin
Dallas
Houston
Los Angeles
New Orleans
Saint Paul

July 20, 2020

The Honorable Kent Sullivan
Commissioner of Insurance
c/o Office of the Chief Clerk
MC 112-2A
Texas Department of Insurance
PO Box 149104
333 Guadalupe St.
Austin, Texas 78714-9104

sent via email: ChiefClerk@tdi.texas.gov

Re: Proposed Amendments to Subchapter E. Texas Windstorm Insurance Association; Division 3, Loss Funding; 28 TAC §§5.4102, 5.4114, 5.4133,5.4134, 5.4141, 5.4142, 5.4160-5.4162, 5.4164, 5.4167 and 5.4171

Dear Commissioner Sullivan:

This letter is sent on behalf of members of the Insurance Council of Texas (ICT), a trade association comprised of over 500 property casualty insurers doing business in Texas. Numerous members of ICT are licensed to write property insurance in Texas and required to be members of TWIA.

The following comments are submitted relating to the above referenced proposed amendments and new sections concerning TWIA's loss funding.

Comments on §5.4102. Definitions. It is recommended that a definition of "catastrophe year" be added to be consistent with the definitions in Tex. Ins. Code §2210.003(3-b).

Under §5.4102 (34) definition of "net premium", the proposed changes to the definition of "net premium" is a deletion of language that permits net premium to be pledged for the payment of Class 1, class 2 and class 3 payment obligations. The funding formula in Ch. 2210, Subchapter B-1 still requires the use of Class 1, 2 or 3 public securities if a catastrophic event occurs in a catastrophe year. HB 1900 did not change that funding order. The deletion of this language may make it either impossible or more difficult to issue bonds in the future if needed for a particular

catastrophe year. If bonds can be issued, they would only be able to be repaid by surcharges. The proposed deleted language should not be adopted.

Under §5.4102(39) definition of Other Revenue, the proposed changes under this definition adds new language that income on funds held by the trust company is not considered to be other revenue. See the comments above. Can future investment income be pledged to repay bonds? Investment income is only derived by premiums paid by policyholders. Will this provision only apply to existing funds held in trust? This language should be clarified to avoid confusion and to assure TWIA can issue future bonds if needed.

Comments on §5.4133.Public Security Proceeds.

Comments on new subsection (f). This section deals with the use of ***pre-event*** public securities and appears to limit use of those proceeds to only the "catastrophe year" for which the proceeds are disbursed. Again, the term "catastrophe year" is not defined in these rules but is defined in Ch. 2210. Disbursements of pre-event bonds may be in a calendar year after the "catastrophe year" because it may take more than one year to issue needed bonds. This raises other questions. For example, under the current funding structure, TWIA may have to issue Class 1, 2 and 3 securities to pay for a Harvey size storm. (Approximately $1.8 Billion) If this size storm was in 2020, this would be the catastrophe year. What if the bonds were not issued and disbursed until 2021 or subsequent years? TWIA used pre-event bonds issued after Hurricane Ike in 2008 to pay for Harvey losses. It is our understanding that funds from these pre-event bonds were held in trust until proceeds were needed to pay for Hurricane Harvey losses. Thus, the proceeds of these pre-event bonds were disbursed in 2017. Under Tex. Ins. Code §2210.608(a) and (c), TWIA can use proceeds to pay for items such as incurred losses, operating expenses, costs of issuing bonds, reinsurance, financial arrangements, and other items that may not be the result of a catastrophe. If a public security is issued on a pre-event basis, the funds could be disbursed or available to TWIA for these purposes. Also, bonds could be issued up to $500 Million. Does this contemplate that pre-event bonds will always be at this maximum amount? What if part, but not all, of the proceeds are needed? Hopefully, these questions will be clarified in the final adoption.

Comments on §5.4160. Member Assessments to Pay for Reinsurance.

Comments on New Proposed Title. The title of this new section should be amended to refer to "Excess Reinsurance Above Required Reinsurance Minimum Levels". HB 1900 *did not* require assessments on members to pay for *all reinsurance*. Instead, HB 1900 added new subsection (d) to Section 2210.453 that only requires an assessment for reinsurance above the minimum levels.

Comments on proposed new Subsection (a). New proposed subsection (a) should be amended to comply with HB 1900 requirements. Without this amendment, the rule may be easily misconstrued to imply that insurers must be assessed for all reinsurance. HB 1900 added subsection (d) and provides that insurers can only be assessed for amounts in excess of the minimum required funding levels contained in §2210.453(a).

The following is a suggested amendment to the proposed caption and proposed subsection (a):

> **"§5.4160. Member Assessments to Pay for Excess Reinsurance Above Required Minimum Reinsurance Levels.** .
>
> (a). The association, with the Commissioner's approval, must assess members for the cost of excess reinsurance as provided by Insurance Code §2210.453(d). If, in a calendar year, the association purchases reinsurance in excess of the minimum levels required to be maintained or purchased under Tex. Ins. Code §2210.453(a), the association must assess its members for the cost of such excess reinsurance under §2210.453(d).

Comments on proposed new subsection (f). This subsection should be amended to refer to the cost of reinsurance for the 1:100 probable maximum loss and cost of reinsurance for coverage in excess of that amount.

Comments on proposed new subsection (i). This subsection should be amended to refer to excess reinsurance costs and also amended to refer specifically to Insurance Code §2210.453(d). Subsection (d) was added by HB 1900. Without such amendments, this could cause confusion and potential disputes on assessments for all reinsurance.

Comments on §5.4161. Member Assessments to Pay Claims. In the preamble, the notice discusses that the phrase "to pay claims" was added to distinguish assessments for purposes other than for excess reinsurance. Instead of adding "to pay claims" to this caption, it is recommended this caption be amended to refer to Member Assessments other than Assessments for Excess Reinsurance. This is a more accurate description of HB 1900 changes.

Also, does use of the word "claims" impliedly limit this to only amounts paid to policyholders? The word "claims" is not defined and assessments under the statute can be authorized to pay for losses including loss adjustment expenses and other expenses. The use of the words "pay claims" may also erroneously suggest that assessments cannot be made or used to pay for other costs such as loss adjustment expenses.

Comments on new proposed subsection (i). The notice adds new language that "proceeds from assessments can only be used for losses and expenses resulting from the *catastrophe year* for which the assessments were made". The notice refers to his amendment is necessary because of HB 1900 changes to Insurance Code §2210.0715. However, §2210.0715 refers to use of reserves and trust funds and does not refer to how assessments can be used. Is this added language necessary as it relates to assessments? If it is necessary, the phrase "catastrophe year for *which the assessment was made*" may add confusion in future applications particularly as it relates to Section 5.4162(b), which will be discussed. Assessments for Hurricane Harvey were made in 2018 and 2020 even though Hurricane Harvey occurred in catastrophe year 2017. It is recommended this subsection be amended or deleted.

Comments on §5.4162. Amount of Assessment.

Comments on subsection (a). This subsection should be amended to be consistent with recommended amendments earlier by referring to "excess reinsurance assessments" and "other assessments".

Comments on subsection (b). The June 19, 2020, notice of proposed changes only proposes stylistic and non-substantive changes to this subsection. Subsection (b) needs to be repealed or amended for several reasons.

First, as presently worded, subsection (b) requires each company's percentage of participation (sometimes referred to as the POP) to be computed on a "calendar year basis for the year in which the assessment is made." This language was added as new language in January 2011 after the passage of H. B. 4409 and has not been amended since 2011. This language should be updated because several of the statutes used by the Department to adopt this subsection have now been amended, repealed or adopted by the Legislature.

Second, this language is inefficient and will be costly to maintain if future assessments are needed after a catastrophe event in one year with assessments made in subsequent years. The impact of this inefficiency is readily apparent on how TWIA has interpreted this section in the recent Hurricane Harvey assessments. Essentially, TWIA has used four different POP years for the Harvey assessments. The first two assessments to pay for Harvey losses were made in 2018 but TWIA used the 2017 POP to assess member insurers because the 2018 POP was not available. The third Harvey assessment was made in 2019 and TWIA used the 2019 POP for this assessment because the data necessary to calculate the 2020 POP will not be available until the end of 2020 or later. TWIA has only recently advised insurers that the assessments made in 2018 using the 2017 POP will now be adjusted to the 2018 POP because the 2018 POP was only recently finalized in 2020. TWIA has advised insurers that amounts collected using the 2019 POP will be revised once the 2020 POP becomes available. This result is inefficient, confusing and causes TWIA and each member insurer to engage in multiple accounting entries that seems unnecessary.

Third, this subsection should be amended because it appears to conflict with key statutory provisions in Chapter 2210 relating to the funding each year for losses. This subsection also may conflict with long-standing language in the TWIA Plan of Operation. For example, Insurance Code §2210.0725(a) authorizes Class 1 assessments and requires assessments after losses in a "catastrophe year" exceed amounts available from premium, trust funds, and Class 1 securities. The existing language in subsection (b) conflicts with Chapter 2210 because assessments are not determined in the year when the assessment is made but instead when losses occur.

The rule also may conflict with Insurance Code §2210.003(3-b) defining a catastrophe year. The term catastrophe year is defined as follows:

> (3-b) "Catastrophe year" means a ***calendar year in which an occurrence or a series of occurrences results in insured losses, regardless of when the insured losses are ultimately paid.*** (Emphasis supplied).

Insurance Code §2210.0725(b) requires member assessments to be determined for the year under Insurance Code §2210.052, which provides in pertinent part as follows:

> Sec. 2210.052. MEMBER PARTICIPATION IN ASSOCIATION. (a) Each member of the association shall participate in insured losses and operating expenses of the association, in excess of premium and other revenue of the association, in the proportion that the net direct premiums of that member during ***the preceding calendar year*** bears to the aggregate net direct premiums by all members of the association, as determined using the information provided under Subsection (b).
>
> (b) The department shall review annual statements, other reports, and other statistics that the department considers necessary to obtain the information required under Subsection (a) and shall provide that information to the association. The department is entitled to obtain the annual statements, other reports, and other statistics from any member of the association.
>
> (c) Each member's participation in the association shall be determined ***annually in the manner provided by the plan of operation***. (Emphasis supplied)

The plan of operation is referred to in the Texas Administrative Code under Title 28, chapter 5, Subchapter E, Division 1, §5.4001. These proposed rule changes are in Division 3 for loss funding. Since its inception, the POP for the current year is based on calculations from the preceding year. So, 2017 POP would be based on writings of members in 2016.

In the plan of operation, §5.4001**(c) Financial Operation of the Association,** there is a discussion on using each calendar year for member's participation that further contemplates that a member's participation for losses occurring in the calendar year should be based on writings in the preceding year. For example, see §5.4001(c)(1)(A):

> (1) Collection, investment, and allocation of funds.
>
> (C) Allocation.
>
> (i) Each year the association will prepare a statement of earnings by calendar year. All premiums written, commissions paid, unearned and earned premiums, ***loss and loss expenses paid and pending will be charged to the calendar year. All general expense and interest income received will be charged or credited to the current calendar year.***
>
> ***(ii) Each company will apply their participation percentage applicable to each calendar year.*** (Emphasis supplied).

This portion of the plan of operation appears to conflict with §5. 4162(b) language that requires a determination in the year the assessment is made.

Fourth, continued use of the year when the assessment is made would be used for both assessments needed to pay losses but also used for "excess reinsurance". This could also lead to conflicting results and assessments that may be made in different years.

Fifth, continued use of the year when the assessment is made may not be beneficial to consumers. If a large storm hits in one year and future assessments are anticipated in subsequent years, consumers may not benefit because the rule may ***discourage carriers from maintaining long-term customer relationships,*** including through the critical years following a loss event requiring TWIA assessments across multiple years, by allowing carriers to decrease their assessment exposure for a prior event through the elimination of business from their books.

Sixth, continued use of existing subsection (b) may discourage companies to write more business in Texas after a storm year or encourage growth in the Texas market because of the possibility of the use of different participation percentages. This may be inconsistent with legislative mandates to encourage more voluntary writings.

Seventh, continued use of existing subsection (b) is inconsistent with sound insurance practices. This is because most, if not all, property carriers apply the expenses and amounts paid out on claims to the policy and policy year in which a weather event occurred. This is true for their own business as well as assessments. Insurers also purchase reinsurance based on the catastrophe year regardless of when losses are actually paid. Subsection (b) changes this by using a process more comparable to a "Claims Made" process rather than an "Occurrence" based process. Only by assessing the members based on their percentages during the year the catastrophe actually took place do you guarantee that those dollars being assessed are generated from the actual risk exposure that the member company had when the catastrophe took place. If a company made the decision to write less property premium in the years after a catastrophe, then the proposed language of this rule could actually reward that company by assessing them a lower amount based on the percentage they are writing in the year of the assessment rather than charging them for the risk they were writing when the catastrophe occurred.

Finally, the current language in subsection (b) should be changed because it does not reflect legislative changes made since subsection (b) was adopted in 2011. The Department is encouraged to review the reasons for adopting §5.4162(b) when notice was published in July 2010 and the reasoned justification for subsection (b) as published in the Texas Register on February 13, 2011.[1]

After subsection (b) was adopted in February 2011, the Legislature adopted several changes. The first was a definition of "catastrophe year" added in a special session in 2011 and

[1] Notice of the Proposed Rule was published in 35 TexReg 6611, 6613, July 30, 2010; Notice of the adopted rule was published in the Texas Register at 36 TexReg 784, 786. 787, and 796, Feb. 16, 2011.

effective in September 2011.[2] Second, were numerous changes to the loss funding provisions made in 2015 that amended and added new sections in Chapter 2210, Subchapter B-1 and repealed Insurance Code §2210.6135, which was relied upon in the reasoned justification in 2011 for subsection (b) of this rule.[3] The third change were those made in 2019, which reaffirmed the legislature's intention to provide separate funding for each catastrophe year and not when assessments are made in a calendar year.[4]

Based on the foregoing, it is recommended that subsection (b) be amended. A possible amendment to the published rule is shown below with yellow highlighted language:

> "(b) Each member company's assessment amount ~~percentage of participation~~ must [~~This determination shall~~] be ~~computed~~ **based on the participation percentages determined for each member for the catastrophe year when the catastrophic event occurred regardless of when losses are paid.** ~~on a calendar year basis for the year in which the assessment is made. The percentage of participation is not based on the year in which the catastrophic event occurred except for an assessment made during that year.~~

The above language or something similar would be consistent with statutory provisions and avoid the confusion of using more than two POP for a single year.

Comments on subsection (g). One member of ICT suggested adding a definition to a "reasonable time" and possible deleting requirements to send this by certified mail.

Comments on subsection (h). See comments above about considering adding a time frame on what constitutes a reasonable time.

Comments on subsection (i). It is recommended the word "excess" be added before reinsurance to be consistent with previous recommendations.

We appreciate the opportunity to provide these comments and hope these rules will be amended or revised as part of any final adoption. Please contact me if you have questions or need additional information in support of these comments.

Sincerely,
/s/ *Jay Thompson*
Jay Thompson

Cc: Albert Betts, Exec. Dir., ICT

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[2] H.B. 3, passed in the 1st Called Session in 2011.

[3] S.B. 900, passed in the Regular Session in 2015.

[4] H.B. 1900, passed in the Regular Session in 2019.